

Internal Revenue Service

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Department of the Treasury

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B04

PLR-105180-08

Date:

October 17, 2008

Legend

Parent

X

Y

Z

State A

State B

State C

Dear :

This is in response to the letter submitted by your authorized representative dated January 30, 2008, requesting rulings concerning the "Wellness Rider."¹

FACTS:

Taxpayer makes the following representations:

X is a life insurance company organized under State A law and is licensed to offer life insurance and annuity products in 49 states and the District of Columbia. Y is a life insurance company organized under State B law and is licensed to offer life insurance and annuity products in State B. Z is a life insurance company organized under State C law and is licensed to offer life insurance and annuity products in all 50 states and the District of Columbia. (Each of X, Y and Z are individually referred to as a "Company" and together as the "Companies").

¹ Described below.

The Companies file a consolidated Federal income tax return with their common parent, Parent, on a calendar-year basis, using the accrual method of accounting. Despite their separate corporate identities, the Companies function largely as a single business enterprise, sharing the same management and staff and issuing similar products in their respective markets.

The Wellness Rider. The Wellness Rider, which will be in substantially the same form for each of the Companies, will be offered in conjunction with certain life insurance contracts issued by the Companies.² For § 7702 purposes, some of the life insurance contracts to which the Wellness Rider will be attached will be tested under the cash value accumulation test³ and others will be tested under the guideline premium/cash value corridor test.⁴

The Wellness Rider will offer benefits to contract owners and insureds. (Typically these are the same persons, but in some cases they may be different, as, for example, where a contract is owned by a trust.) Specifically, the Wellness Rider will provide two benefits:

- “Wellness Benefits” will include a full menu of educational materials provided by a reputable wellness service provider to educate the insured on the benefits of leading a healthy lifestyle.
- “Wellness Rewards” will be in the form of a discount on current cost of insurance (“COI”) charges⁵ (the “COI discount”) that will be available for contracts that insure individuals who periodically satisfy certain Wellness Qualification Criteria.⁶

As a condition to the COI discount under the Wellness Rewards benefit, insureds must satisfy two criteria within a 24 month period, (a) the completion of a routine physical examination by a licensed physician and (b) maintenance of the insured’s weight within a range that is established at contract issue as part of the initial underwriting process (together, the “Wellness Qualification Criteria”). Satisfaction of the Wellness

² The Wellness Rider will only be available on new contracts and will not be made available to existing contracts.

³ Section 7702(b).

⁴ Section 7702(c) and § 7702(d).

⁵ Under a “universal life” or similar type of cash value life insurance contract that does not require fixed premium payments and does not provide a table of guaranteed cash values at each duration, the cash value is determined periodically by crediting interest to and subtracting charges from the cash value at the previous duration (with adjustments for premium payments and distributions). Among these charges are charges for the insurance protection provided by the contract, which are known as cost of insurance (“COI”) or mortality charges. COI/mortality charges are determined by multiplying a mortality rate (which increases with the age of the insured) by the “net amount at risk” (the difference between the death benefit and the cash value, *i.e.*, the pure insurance element of the contract). Mortality rates are determined with reference to a particular mortality table, such as the 1980 or 2001 Commissioners Standard Ordinary (“CSO”) mortality tables.

⁶ Defined below.

Qualification Criteria by the insured allows the contract to participate in any COI discount declared under the Wellness Rewards benefit for the next two contract years. If the insured visits the licensed physician but does not meet the weight requirement, the contract will receive a smaller COI discount. The Companies will not use the results of the physical examinations to classify insureds; indeed, an insured will not be required to report the results to the applicable insurer but will only be required to submit verification by a licensed physician that the insured has undergone the required physical examination during the applicable 24-month period.

While it is expected that the COI discount will be declared annually, the discount will not be guaranteed. Rather, the COI discount will be set at the discretion of the Companies, taking into consideration factors including, but not limited to, the Companies' future expectations of mortality and persistency for the cohort of insureds that meet and that are expected to continue to meet the Wellness Qualification Criteria. If declared, the COI discount will be applied to reduce the current mortality charges otherwise declared under the life insurance contracts. Even if a COI discount is declared for a particular year, the discount (like the current mortality charges declared under the contracts to which the Wellness Rider is attached) will not be guaranteed: the applicable Company will reserve the right to increase, reduce or discontinue the COI discount provided under the Wellness Rewards benefit at any time.

Contracts will be assessed an administrative expense charge of \$100 in the first contract year for the Wellness Rider, and each Company may reserve the right to assess a comparable administrative expense charge in subsequent years. (Currently, the Companies only intend to assess the administrative expense charge in the first contract year.) The Companies will not take this charge into account in computing guideline, net single or 7-pay premiums under either §§ 7702 or 7702A. Nor will the Companies treat either the benefits provided under the Wellness Rider or the charge for the Wellness Rider as a "future benefit". In this respect, the Companies intend to treat the Wellness Rider as an "additional benefit which is not a qualified additional benefit" within the meaning of § 7702(f)(5)(C).

In calculating net single premiums for purposes of the cash value accumulation test set forth in § 7702(b), guideline level premiums and guideline single premiums for purposes of the guideline premium limitation set forth in § 7702(c) and 7-pay premiums for purposes of the 7-pay test set forth in § 7702A(b), the Companies propose to reduce the COI charges otherwise taken into account under Notice 2006-95, 2006-45 I.R.B. 848 (Oct. 13, 2006), by the amount of the anticipated discount (*i.e.*, the amount by which the anticipated current mortality charges exceed the anticipated discounted mortality charges for the pool of contracts expected to qualify for the Wellness Rewards benefit based on the applicable Company's actuarial best estimates at contract issuance (the "Reduction Methodology")).

RULINGS REQUESTED:

Ruling 1. A contract designed to satisfy the cash value accumulation test set forth in § 7702(b) to which the Wellness Rider is attached will not fail to satisfy the cash value accumulation test solely because the applicable Company does not perform an adjustment under § 7702(f)(7) or treat the contract as a newly issued contract each time the Company declares or credits a COI discount due to the contract holder's satisfaction of the Wellness Qualification Criteria, provided that the Company uses the Reduction Methodology upon contract issuance in calculating the net single premium which would have to be paid at each duration to fund future benefits under a contract within the meaning of § 7702(b)(1).

Ruling 2. A contract designed to satisfy the guideline premium limitation set forth in § 7702(c) and the cash value corridor set forth in § 7702(d) to which the Wellness Rider is attached will not fail to satisfy the guideline premium limitation solely because the applicable Company does not perform an adjustment under § 7702(f)(7) or treat the contract as a newly issued contract each time the Company declares or credits a COI discount due to the contract holder's satisfaction of the Wellness Qualification Criteria, provided that the Company uses the Reduction Methodology upon contract issuance in calculating the guideline single premium within the meaning of § 7702(c)(3) and the guideline level premium within the meaning of § 7702(c)(4) for the contract.

Ruling 3. A contract to which the Wellness Rider is attached will not fail to satisfy the 7-pay test set forth in § 7702A(b) solely because the applicable Company does not treat the contract as having undergone a material change within the meaning of § 7702A(c)(3) or otherwise as a newly issued or entered into contract each time the Company declares or credits a COI discount due to the contract holder's satisfaction of the Wellness Qualification Criteria provided that the Company uses the Reduction Methodology upon contract issuance in calculating the net level premium which would have to be paid if the contract provided for paid-up future benefits after the payment of 7 level annual premiums for purposes of § 7702A(b).

Law and Analysis:

Section 7702(c)(3)(B)(i) provides that "reasonable mortality charges [must] meet the requirement (if any) prescribed in regulations and which (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners' standard tables (as defined in § 807(d)(5)) as of the time the contract is issued." This standard must be used in the cash value accumulation test and guideline premium limitation computations for purposes of the definition of "life insurance contract" set forth in § 7702, and 7-pay test computations for purposes of the modified endowment contract ("MEC") rules set forth in § 7702A. The standard set forth in § 7702(c)(3)(B)(i) as part of the parameters for computing the guideline single premium and is incorporated by reference in the other relevant provisions (§ 7702(b)(2)(B) and § 7702(c)(1)(B)), applies in computing—

- the net single premium (“the net single premium which would have to be paid [at a particular time] to fund future benefits under the contract”) for purposes of the cash value accumulation test, see § 7702(b)(2)(B),
- the guideline single premium (“the premium at issue with respect to future benefits under the contract”) for purposes of the guideline premium limitation, see § 7702(c)(3)(B)(i),
- the guideline level premium (“the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium”) for purposes of the guideline premium limitation, see § 7702(c)(4), and
- the 7-pay premium (“the net level premium [which would be paid] if the contract provided for paid-up future benefits after the payment of 7 level annual premiums”) for purposes of the 7-pay test, see § 7702A(c)(1)(B).

Each of these quantities must be determined using—

reasonable mortality charges which meet the requirements (if any) prescribed in regulations and which (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners’ standard tables (as defined in § 807(d)(5)) as of the time the contract is issued.

See § 7702(c)(3)(B)(i).

The Service has examined the “reasonable mortality charge” requirement in Notice 88-128, 1988-2 C.B. 540, Notice 2004-61, 2004-2 C.B. 596, and Notice 2006-95, *supra*. These rulings allow the use in cash value accumulation test, guideline premium limitation and 7-pay test computations of—

- mortality charges that do not exceed 100% of the mortality charges specified in the 1980 Commissioners’ Standard Ordinary (“CSO”) mortality tables in the case of contracts issued before 2009, or
- the lesser of mortality charges that do not exceed 100% of the mortality charges specified in the 2001 CSO mortality tables or mortality charges that do not exceed the mortality charges specified in the contract at issuance in the case of contracts issued after 2008 and, under certain circumstances, in

the case of contracts issued before 2008, as well.⁷ See Notice 2006-95, § 4.03.

Thus, guaranteed mortality charges that do not exceed 100 percent of the mortality charges specified in the applicable CSO mortality tables (*i.e.*, the 1980 CSO tables or the 2001 CSO tables) may be used in § 7702 and § 7702A computations, even if the insurer actually imposes lower current mortality charges from time to time over the life of the contract on a discretionary basis. In the case of contracts relying on the 2001 CSO mortality tables, if lower mortality charges are specified in the contract at issuance, those mortality charges must be used.

Both the availability and the amount of the COI discount under the Wellness Rider will be wholly within the Companies' discretion and will not be guaranteed or specified in the contracts to which the Wellness Rider will be attached. The current mortality charges against which the COI discount will be applied will also not be guaranteed or specified in such contracts. The Companies may use 100 percent of the mortality charges specified in the applicable CSO mortality tables in their § 7702 and § 7702A computations for contracts to which the Wellness Rider is attached, without taking into account COI discounts under the Wellness Rider.

Under the Reduction Methodology proposed by the Companies, for standard contracts, the Companies will use mortality charges determined by reducing 100% of the mortality charges specified in the applicable CSO mortality tables (which are the mortality charges guaranteed under the contracts) by the amounts of anticipated COI discounts in its § 7702 and § 7702A computations. The guaranteed rates will not exceed 100% of the applicable mortality charge set forth in applicable CSO mortality tables. Therefore, the Companies' reduced mortality charges comply with the reasonable mortality charge requirement of § 7702(c)(3)(B)(i), as implemented by Notice 2006-95 and Notice 88-128.

Section 7702(f)(7) requires "proper adjustments in future determinations" under § 7702 if "there is a change in the benefits under (or in other terms of) the contract that was not reflected in any previous determination or adjustment made under [§ 7702]." Similarly, § 7702A(c)(3)(A) provides that "[i]f there is a material change in the benefits under (or in other terms of) the contract which was not reflected in any previous determination under [§ 7702A]," the contract must be treated as a newly issued contract as of the date of the change and appropriate adjustments must be made in determining whether the contract meets the 7-pay test to take into account the cash surrender value under the contract. Any change in a mortality guarantee would be a change in the terms of a life insurance contract that would require a § 7702(f)(7) adjustment and would be a material change requiring a redetermination under § 7702A.

⁷ Under certain limited circumstances not relevant here, mortality charges based on the 1958 CSO mortality tables can be used for contracts issued before December 31, 1988. See Notice 88-128, *supra*.

The declaration of a COI discount pursuant to the Wellness Rider, however, will not be a change in a mortality guarantee under a contract. The contracts to which the Wellness Rider will be attached, will not guarantee current mortality charges beyond the maximum guarantee based on the applicable CSO mortality table. Thus, a periodic declaration by a Company over the life of a contract discounting current mortality charges by discretionary COI discounts does not result in a § 7702(f)(7) adjustment or a § 7702A(c)(3)(A) material change.

Satisfaction of the Wellness Qualification Criteria should not be viewed as the issuance of a new contract. Satisfaction of the Wellness Qualification Criteria will not result in any new mortality charge guarantee or any other material change in the rights and obligations under a contract. Instead, satisfaction of the Wellness Qualification Criteria will be taken into account in the process of setting current mortality charges for the contract, which are wholly within the discretion of the Companies. This will occur within a framework established by the terms of the existing contract that allows the Companies, on a discretionary basis, to impose lower mortality charges than those guaranteed. In addition, the Companies also propose to use the Reduction Methodology to reasonably give effect to the impact of the COI discount on mortality charges. Therefore the satisfaction of the Wellness Criteria does not cause a contract to become newly issued.

Conclusions:

Ruling 1. A contract designed to satisfy the cash value accumulation test set forth in § 7702(b) to which the Wellness Rider is attached will not fail to satisfy the cash value accumulation test solely because the applicable Company does not perform an adjustment under § 7702(f)(7) or treat the contract as a newly issued contract each time the Company declares or credits a COI discount due to the contract holder's satisfaction of the Wellness Qualification Criteria, provided that the Company uses the Reduction Methodology upon contract issuance in calculating the net single premium which would have to be paid at each duration to fund future benefits under a contract within the meaning of § 7702(b)(1).

Ruling 2. A contract designed to satisfy the guideline premium limitation set forth in § 7702(c) and the cash value corridor set forth in § 7702(d) to which the Wellness Rider is attached will not fail to satisfy the guideline premium limitation solely because the applicable Company does not perform an adjustment under § 7702(f)(7) or treat the contract as a newly issued contract each time the Company declares or credits a COI discount due to the contract holder's satisfaction of the Wellness Qualification Criteria, provided that the Company uses the Reduction Methodology upon contract issuance in calculating the guideline single premium within the meaning of § 7702(c)(3) and the guideline level premium within the meaning of § 7702(c)(4) for the contract.

Ruling 3. A contract to which the Wellness Rider is attached will not fail to satisfy the 7-pay test set forth in § 7702A(b) solely because the applicable Company does not treat the contract as having undergone a material change within the meaning of § 7702A(c)(3) or otherwise as a newly issued or entered into contract each time the Company declares or credits a COI discount due to the contract holder's satisfaction of the Wellness Qualification Criteria provided that the Company uses the Reduction Methodology upon contract issuance in calculating the net level premium which would have to be paid if the contract provided for paid-up future benefits after the payment of 7 level annual premiums for purposes of § 7702A(b).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/S/

Sheryl B. Flum
Branch Chief, Branch 4
(Financial Institutions & Products)